

Under what scenarios can taxes and transfers eradicate extreme poverty and fulfill the demands/needs of the vulnerable and the emerging middle class?

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**Latin America's Coming Transformation:
Escaping the Middle Income Trap**

CGD-CIEPLAN

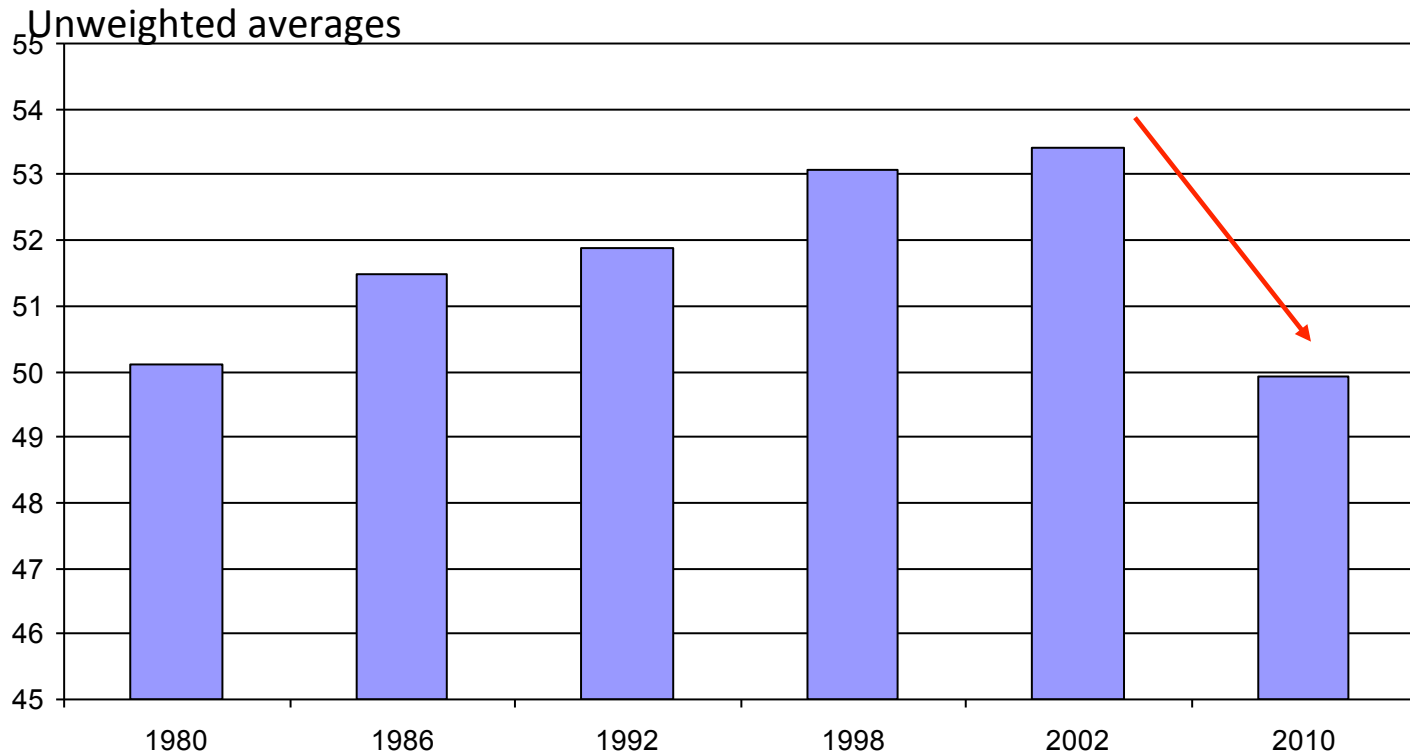
Washington, DC, June 11, 2012

Inequality in 30 Years

- Inequality and poverty rose in the lost decade of the 1980s
- Inequality rose and poverty stagnated during market-oriented reforms of the 1990s
- Inequality and poverty declined in the 2000s throughout the region

Inequality in 30 Years

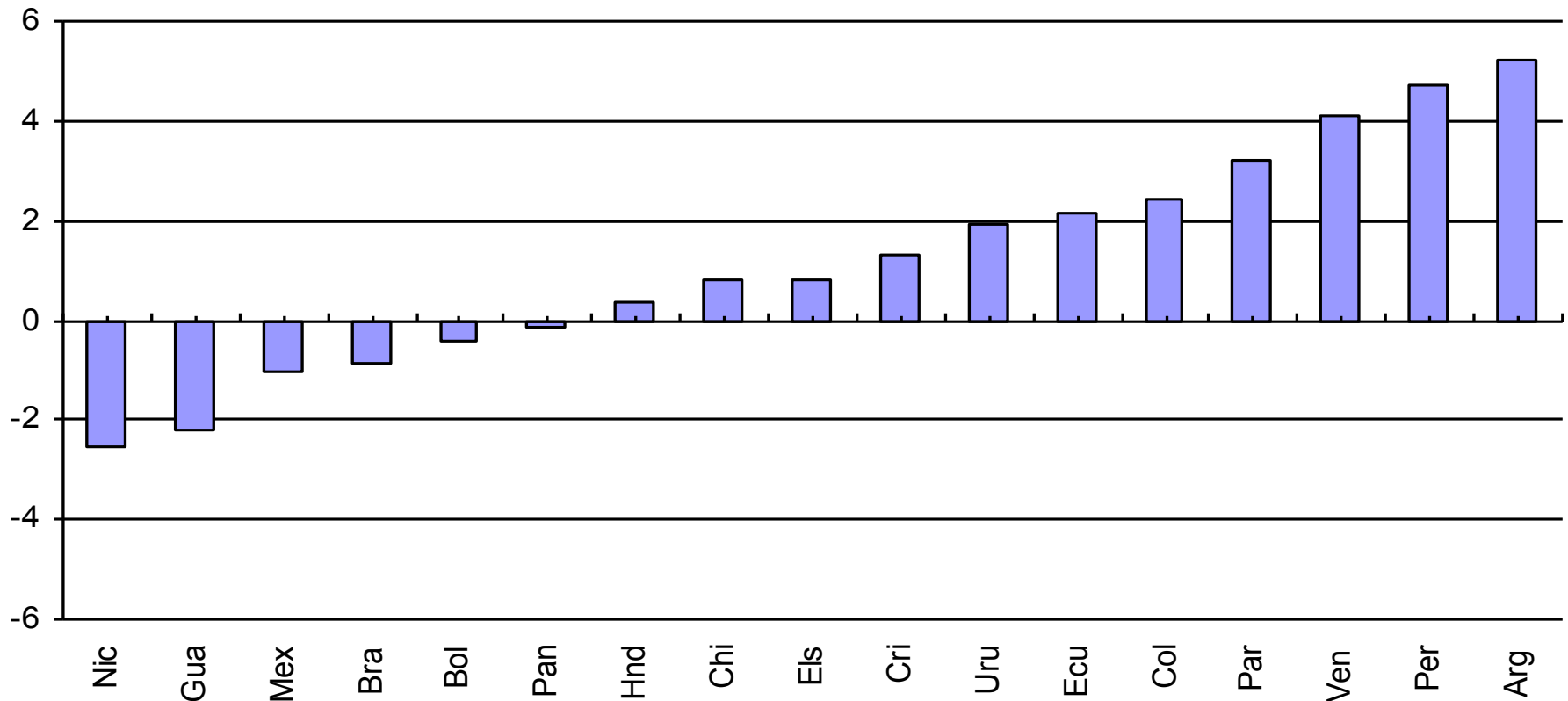
Gini coefficient – Household per capita income



Source: own estimates based on SEDLAC (CEDLAS and World Bank).

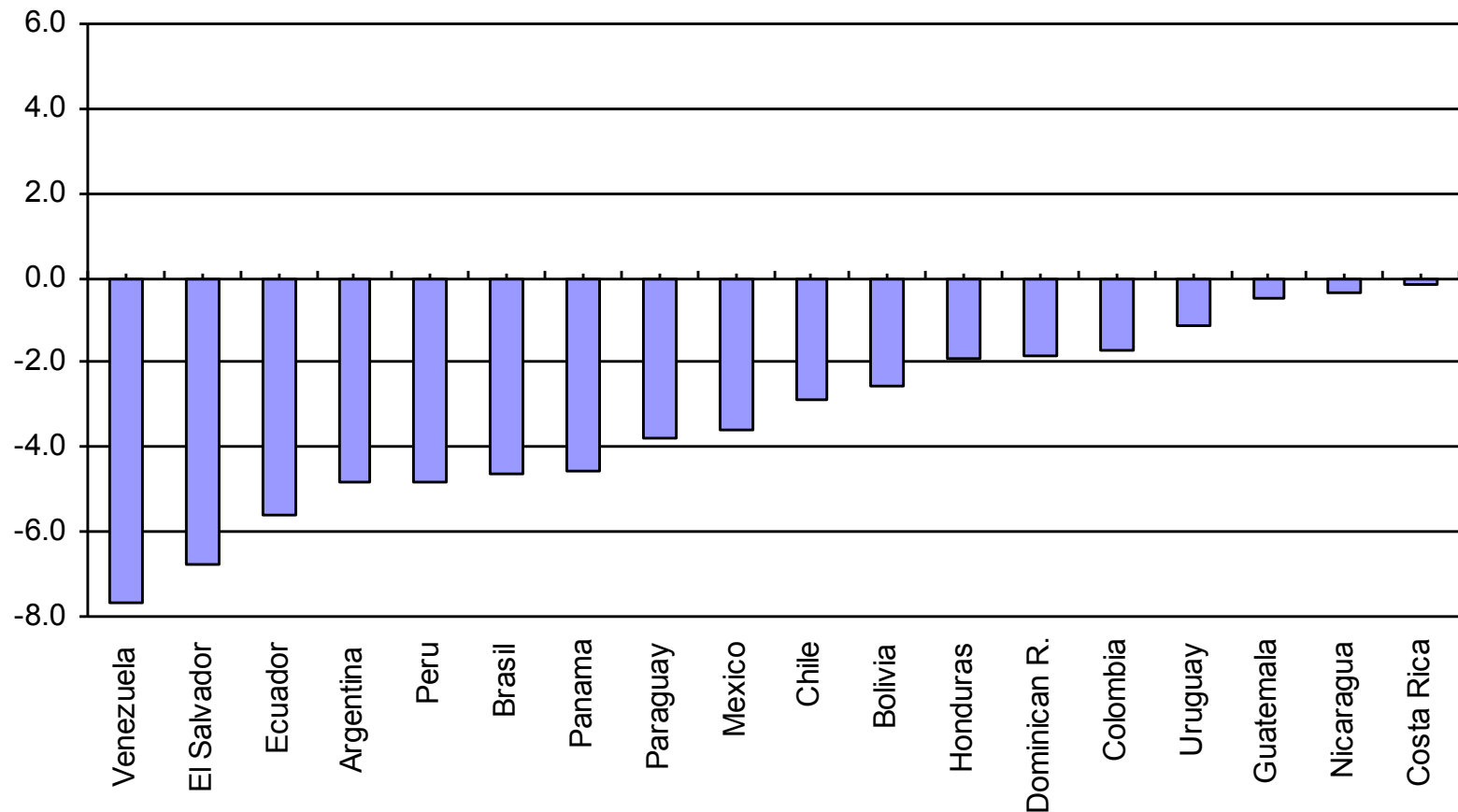
Inequality in the 1990s

Change in Gini coefficient

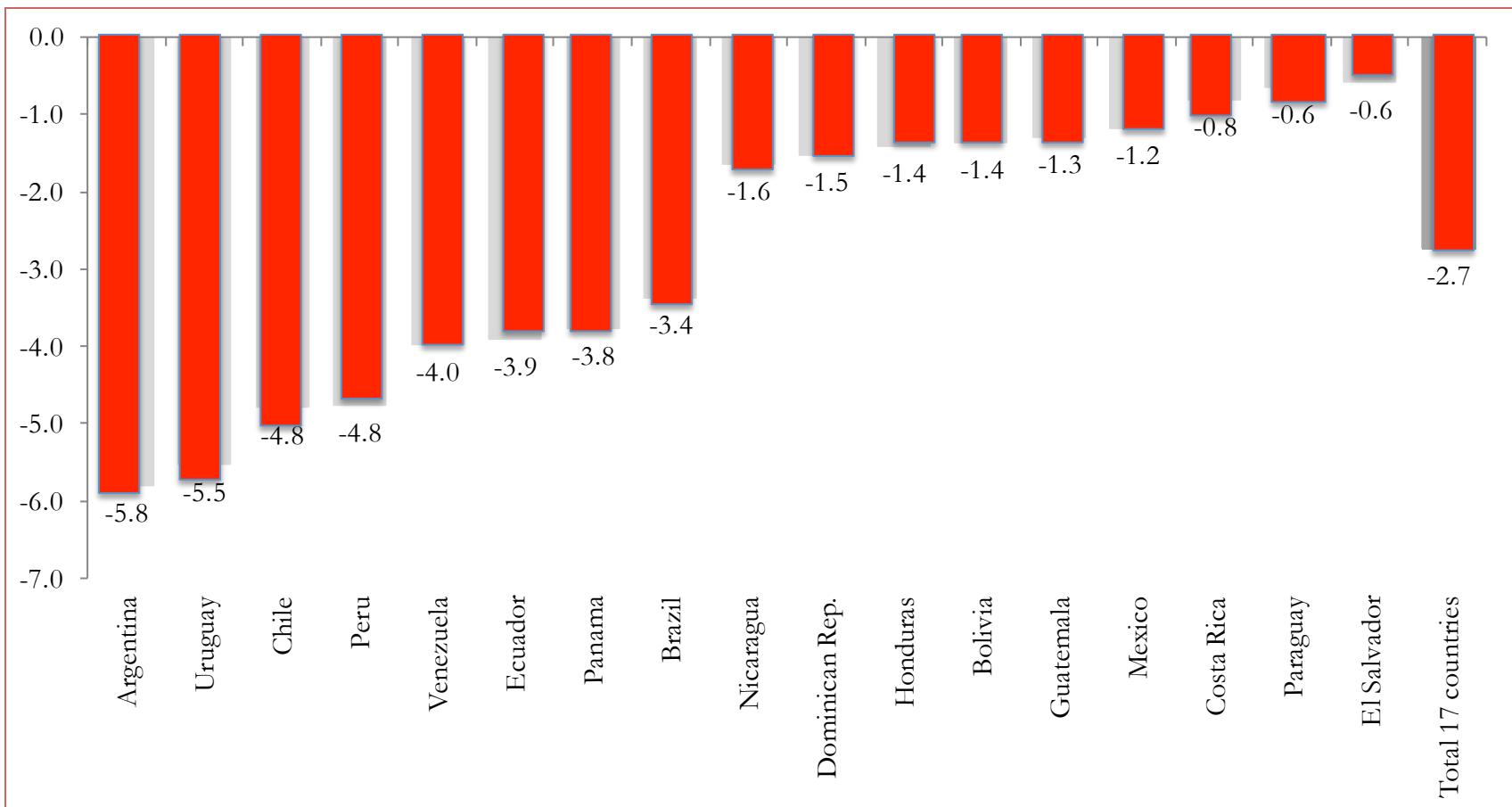


Inequality in the 2000s

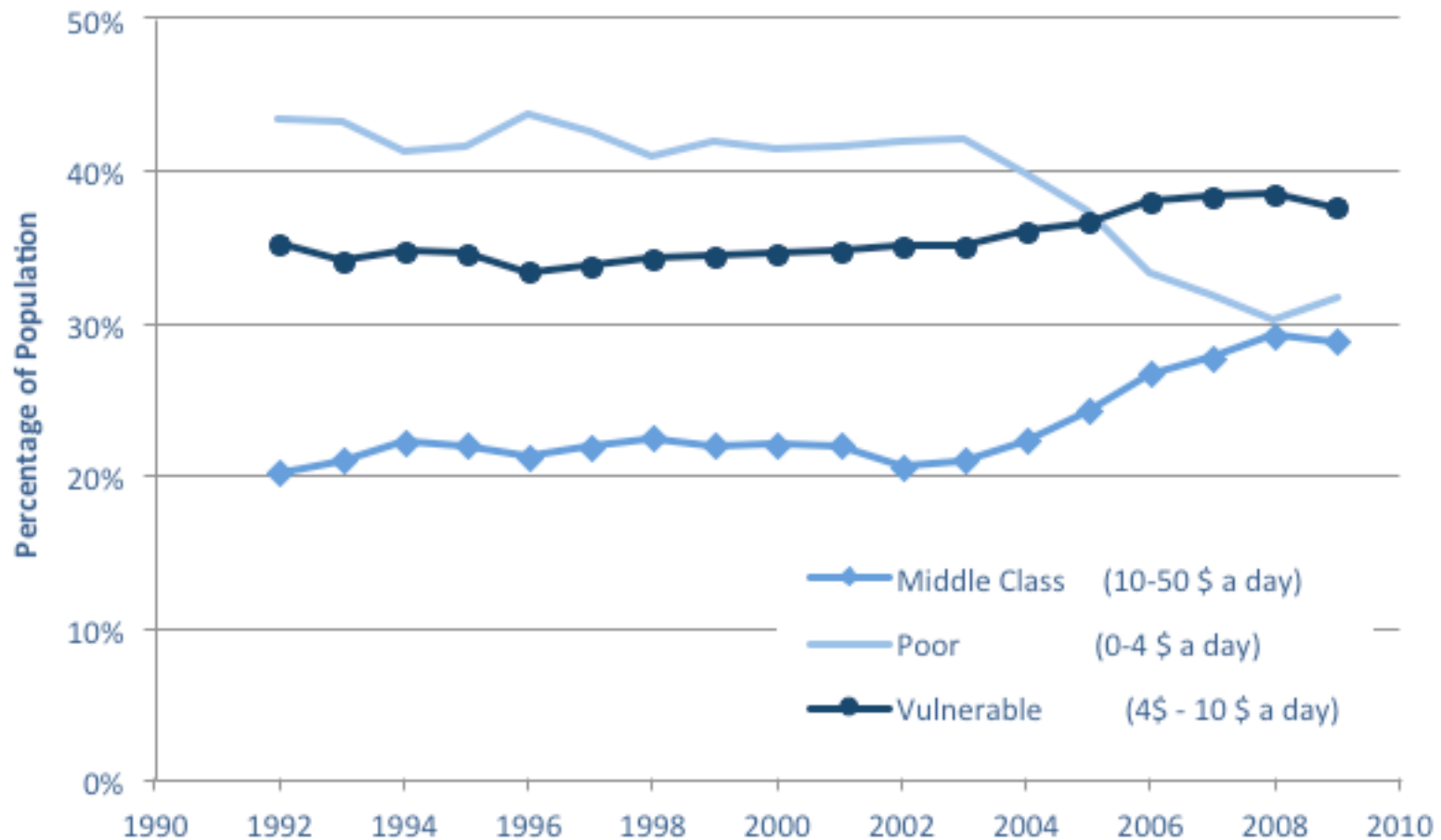
Change in Gini coefficient



Extreme Poverty (US\$2.50/day ppp) in the 2000s

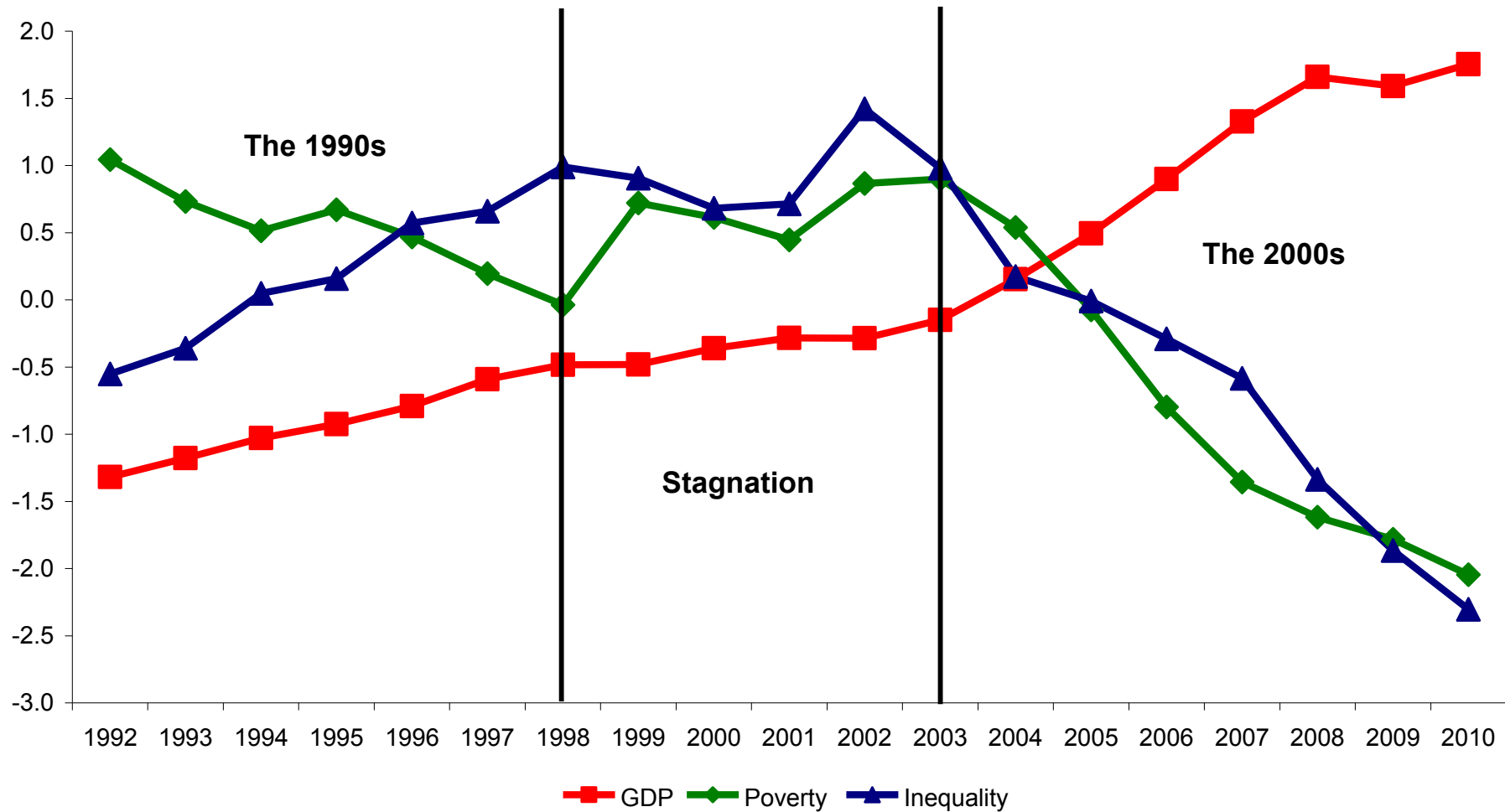


Poor, Vulnerable Groups and the Middle Class



Poverty, growth and inequality

Latin America, 4 USD PPP international poverty line



Source: own estimates based on SEDLAC (CEDLAS and World Bank).

Why did inequality fall in the 2000s?

Demographic factors

Labor markets: Fall in wage gap

- Higher demand for low-skilled workers
- Higher employment

Policy

- Educational upgrading
- Increase in government transfers targeted to the poor: the CCT “revolution”
- Increase in minimum wages

Fiscal Policy, Inequality and Poverty

Commitment to Equity Project

- Commitment to Equity (CEQ) Initiative; Inter-American Dialogue and Tulane University's CIPR and Dept. of Economics.
- Currently: 12 countries
- 6 finished: Argentina (2009), Bolivia (2007), Brazil (2009), Mexico (2008) Peru (2009) and Uruguay (2009) (year of HH survey)
- 6 in progress: Chile, Colombia, Costa Rica, El Salvador, Guatemala, Paraguay

References

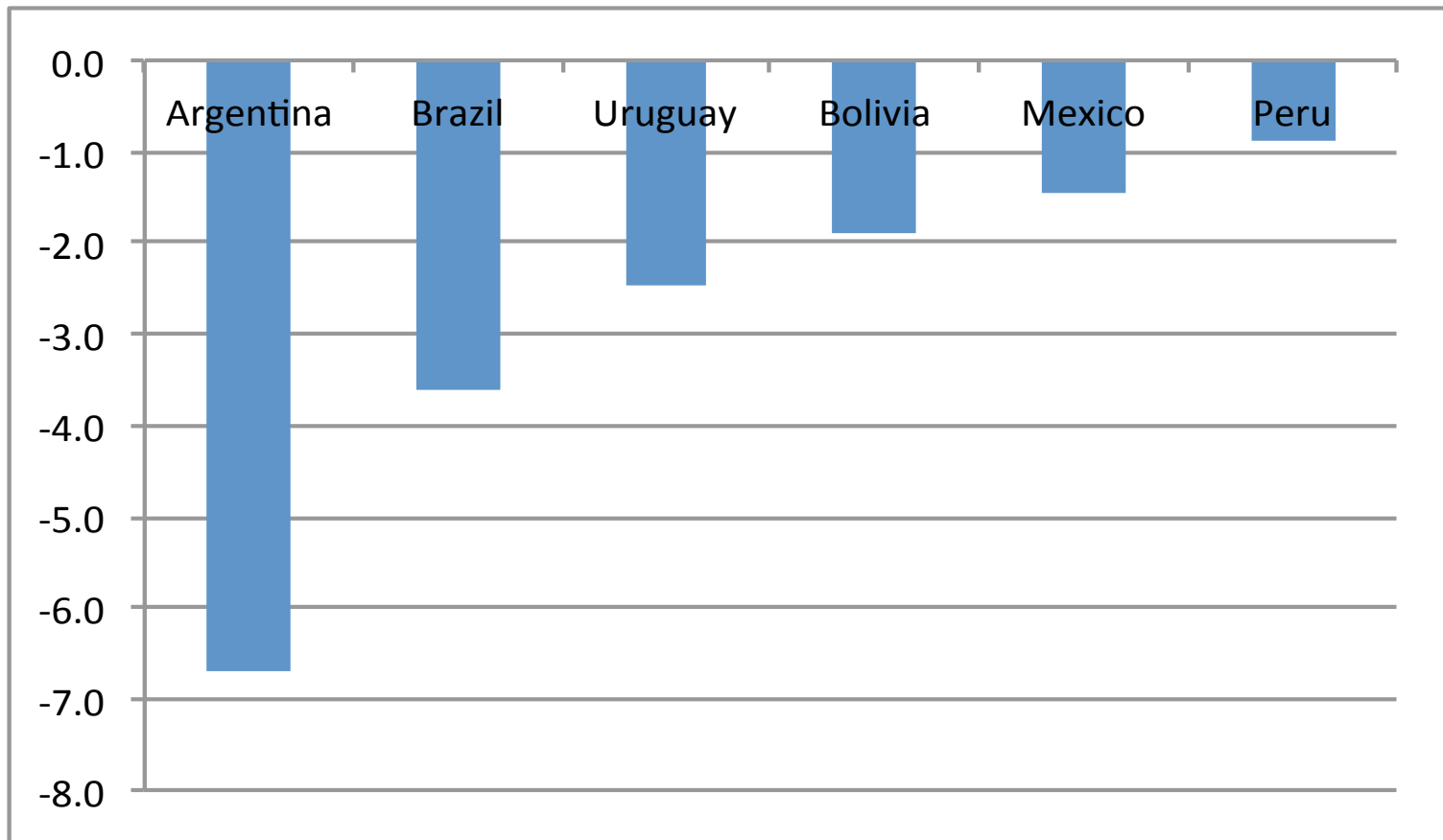
- Lustig, Nora (coordinator). “Fiscal Policy and Income Redistribution in Latin America: Challenging the Conventional Wisdom,” Argentina: Carola Pessino; Bolivia: George Gray Molina, Wilson Jimenez, Verónica Paz, Ernesto Yañez; Brazil: Claudiney Pereira, Sean Higgins; Mexico: John Scott; Peru: Miguel Jaramillo. , Economics Department, Working Paper 1202, New Orleans, Louisiana, April 2012. Forthcoming.
- Lustig and Higgins (2012) “Fiscal Incidence, Fiscal Mobility and the Poor: a New Approach,” to be presented at *Well-being and inequality in the long-run: measurement, history and ideas*, Universidad Carlos III, Madrid, May 31 and June 1, 2012

References

- Bucheli, M., N. Lustig, M. Rossi and F. Amabile (2012) “Social Spending, Taxes and Income Redistribution in Uruguay,” mimeo, Tulane Universidad, Universidad de la Republica and World Bank
- Lustig, N. (2012) “Taxes, Transfers and Income Redistribution in Latin America,” *Sol Linowitz Forum*, Washington, DC.

Decline in Inequality and Poverty due to Direct Taxes and Transfers

Decline in Inequality (Gini coefficient; in %)



Decline in Poverty (Headcount Ratio with US\$2.50 a day poverty line; in %)

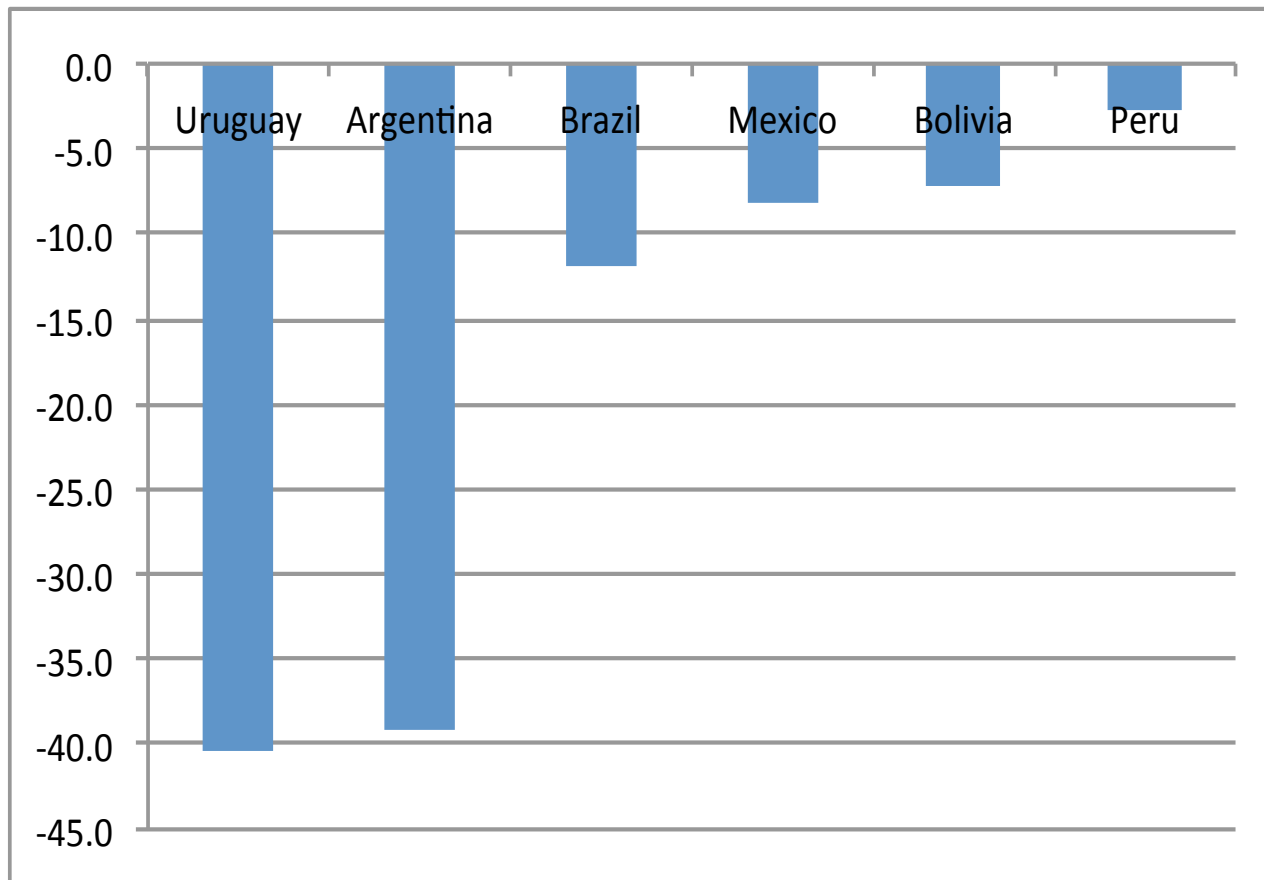
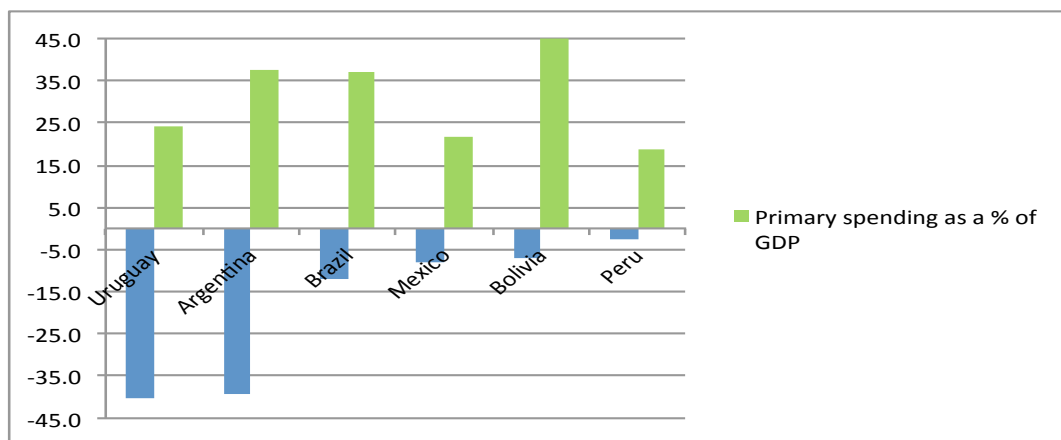


Figure 4 - Government Spending and Decline in Inequality and Extreme Poverty

Large governments do not necessarily lower inequality by more...



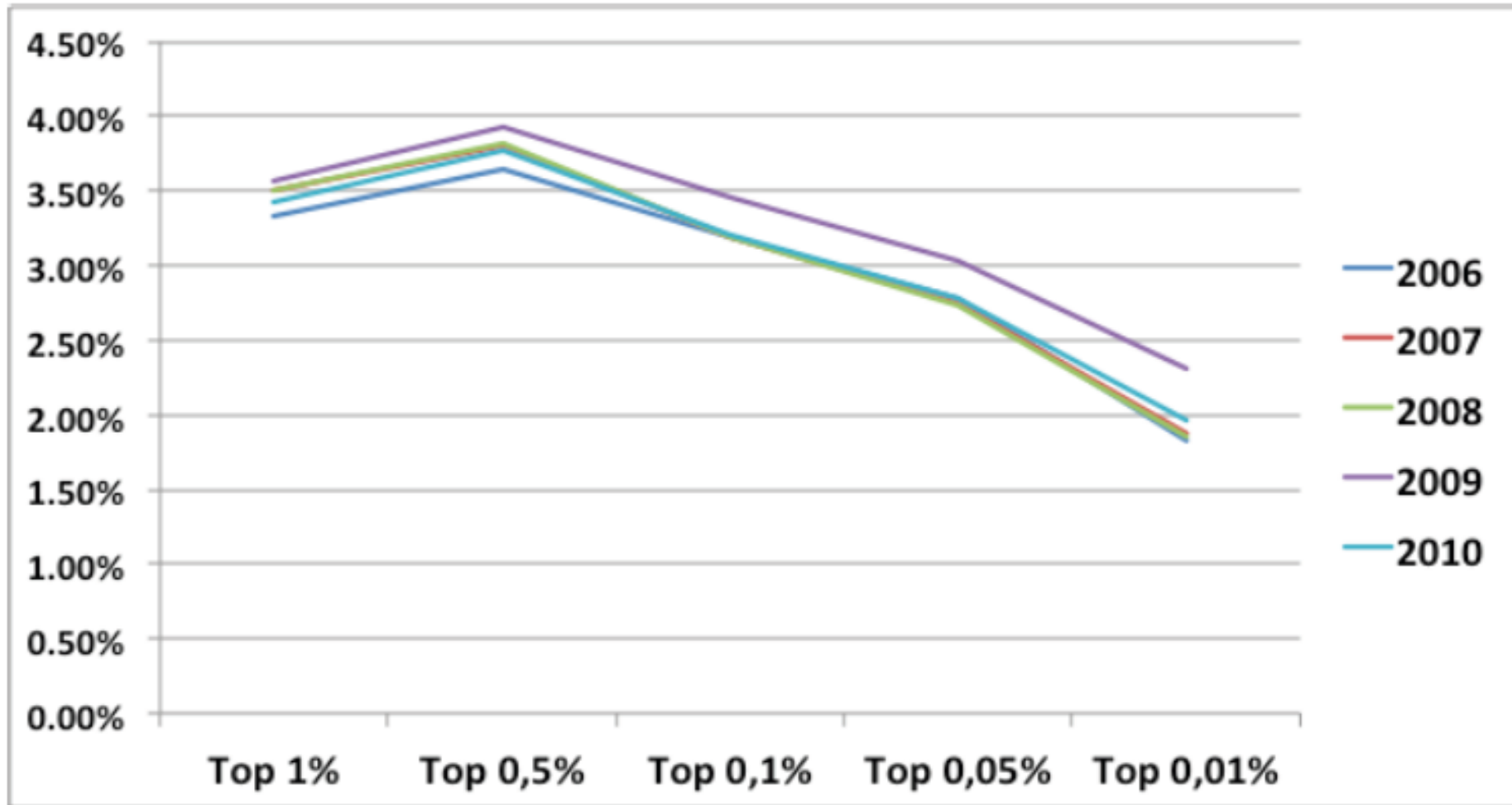
Large governments do not necessarily lower extreme poverty by more...



Source: Lustig, coordinator (2012). Percentage change in Gini coefficient and headcount ratio for the US\$2.50 a day poverty line. Primary spending excludes debt servicing.

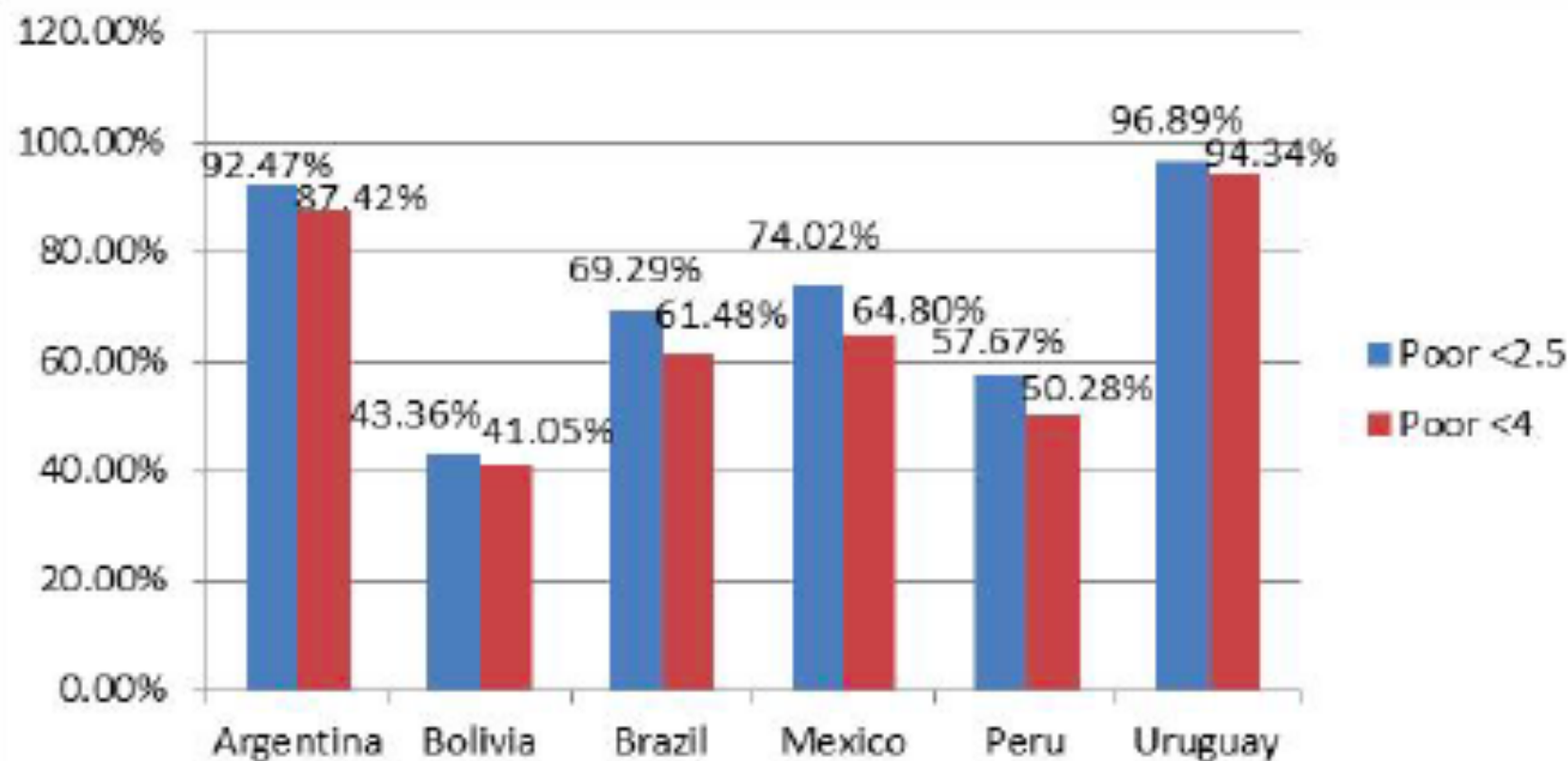
Income Taxes on the very Rich are Low

Colombia: Effective Income Tax Rates at the Top



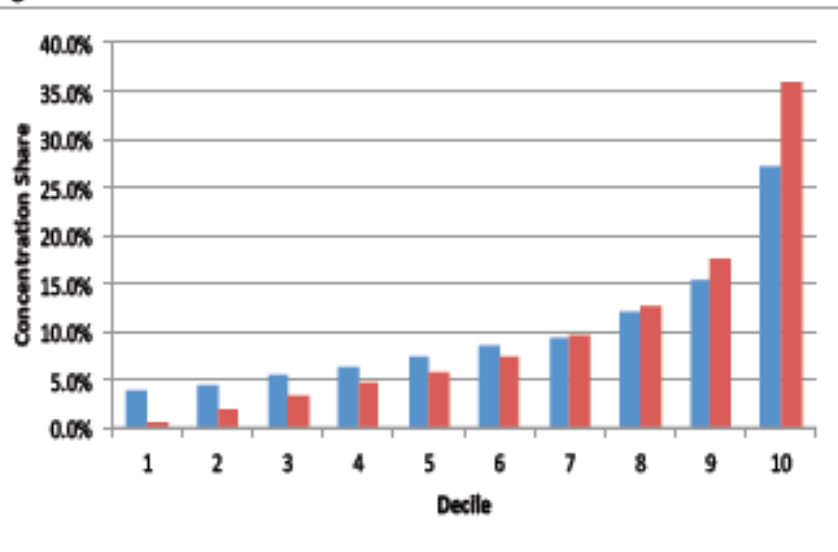
Excluded (from gov. transfers) Poor

Percent of Poor who are Beneficiaries

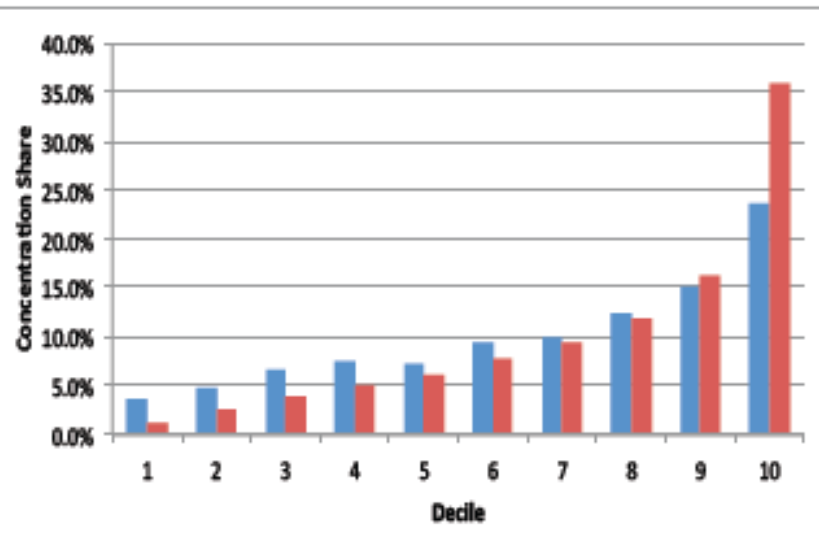


Indirect Taxes are Regressive

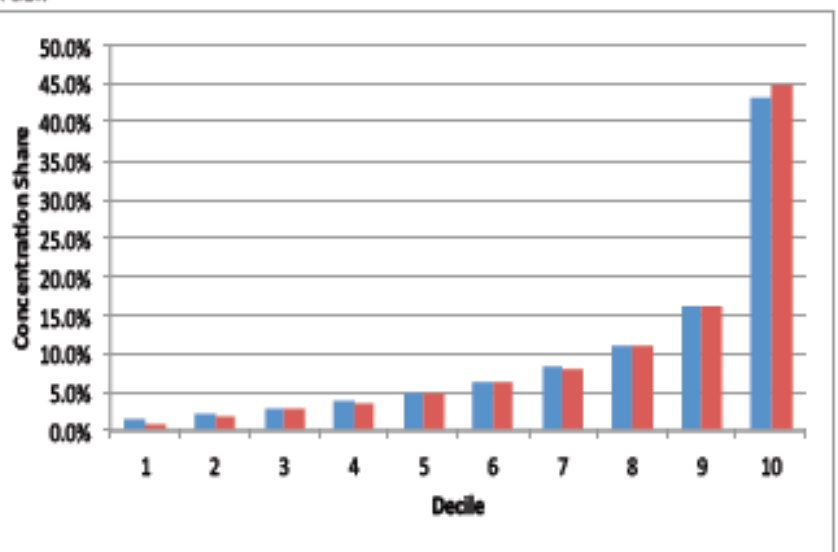
Argentina



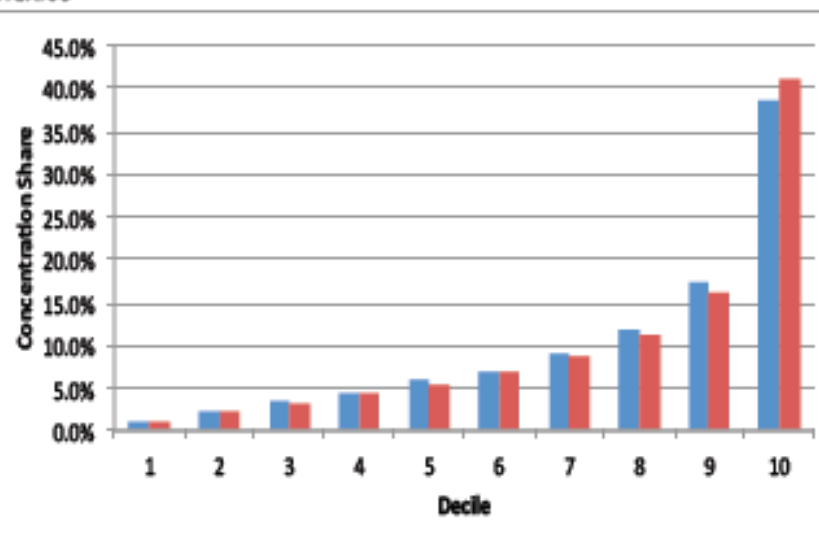
Bolivia



Brazil

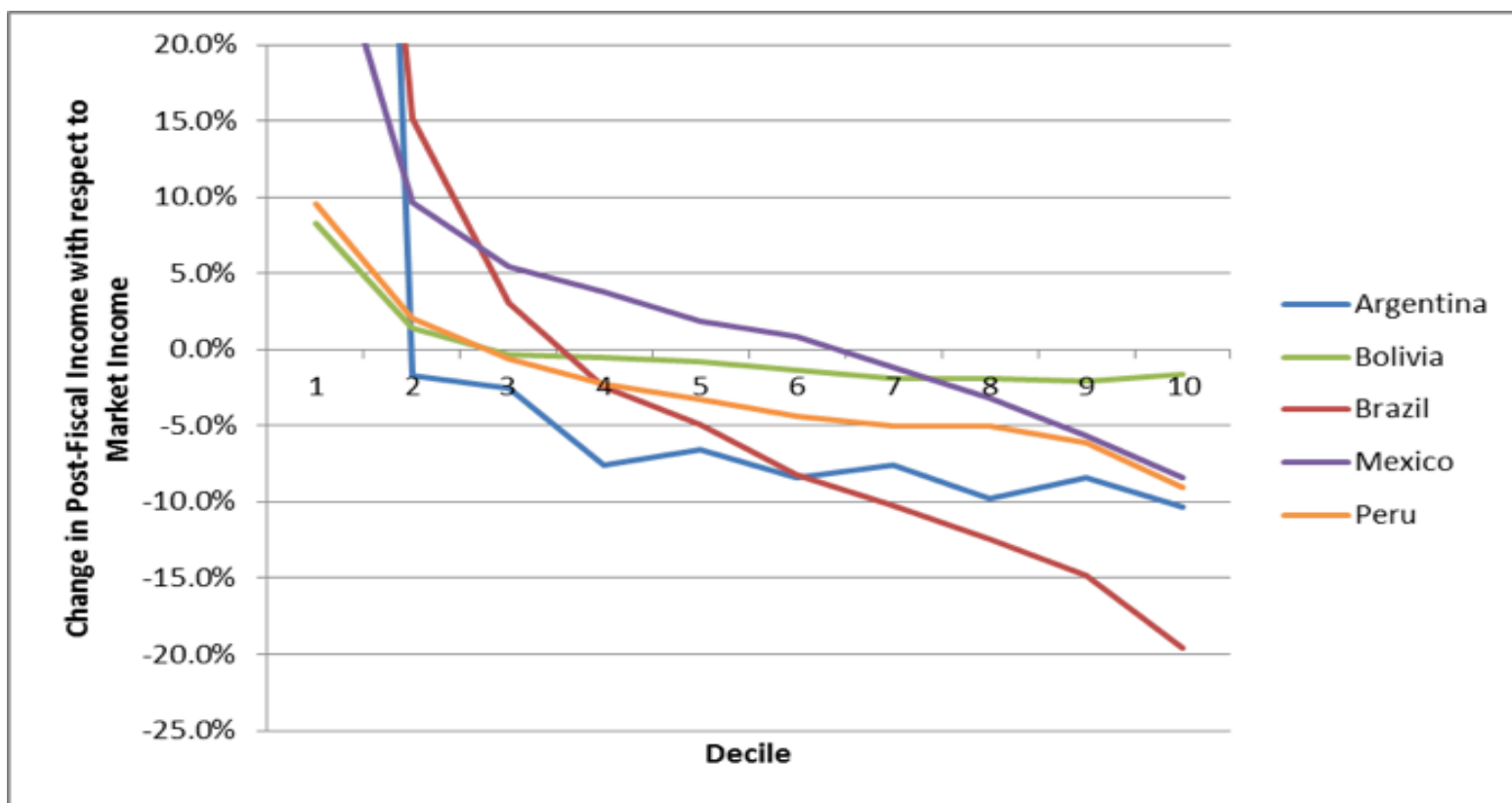


Mexico



Poor and near poor become net payers to the state with indirect taxes

Figure 7 – Change in Income by Decile After Cash Transfers and Direct and Indirect Taxes



Indirect Taxes Impoverish the Poor

Fiscal Mobility Matrix: Brazil

		After taxes and transfers groups						% of Pop.	Mean Income
		< 1.25	1.25–2.50	2.50–4.00	4.00–10.00	10.00–50.00	> 50.00		
Before taxes and transfers groups	< 1.25	69%	21%	6%	3%			5.7%	\$0.74
	1.25–2.50	4%	81%	10%	4%			9.6%	\$1.89
	2.50–4.00		15%	75%	9%	1%		11.3%	\$3.24
	4.00–10.00			11%	86%	3%		33.6%	\$6.67
	10.00–50.00				15%	85%		35.3%	\$19.90
	> 50.00					32%	68%	4.5%	\$94.59
% of Pop.		4.3%	10.7%	13.5%	35.8%	32.5%	3.2%	100%	\$14.15
Mean Income		\$0.86	\$1.91	\$3.25	\$6.61	\$19.34	\$88.70	\$12.17	

Average Proportional Losses: Brazil

		After taxes and transfers groups					% of Pop.	Group Avg.
		< 1.25	1.25–2.50	2.50–4.00	4.00–10.00	10.00–50.00		
Before taxes and transfers groups	< 1.25	–10% \$0.83					5.7%	–10% \$0.83
	1.25–2.50	–13% \$1.34	–10% \$2.01				9.6%	–10% \$1.96
	2.50–4.00		–14% \$2.71	–11% \$3.40			11.3%	–11% \$3.27
	4.00–10.00			–15% \$4.36	–14% \$7.04		33.6%	–14% \$6.70
	10.00–50.00				–16% \$10.98	–16% \$21.76	35.3%	–16% \$20.03
	> 50.00					–22% \$56.66	4.5%	–21% \$94.99
% of Pop.		4.3%	10.7%	13.5%	35.8%	32.5%	3.2%	100%
Group Avg.		–11% \$0.95	–11% \$2.20	–12% \$3.73	–14% \$7.73	–16% \$23.46	–21% \$113.3	–14.5% \$16.10

Fiscal Mobility Matrix: Neutral Tax

		After taxes and transfers groups						% of Pop.	Mean Income
		< 1.25	1.25–2.50	2.50–4.00	4.00–10.00	10.00–50.00	> 50.00		
Before taxes and transfers groups	< 1.25	69%	20%	7%	4%	1%		5.7%	\$0.74
	1.25–2.50	7%	78%	9%	5%	1%		9.6%	\$1.89
	2.50–4.00		22%	67%	9%	1%		11.3%	\$3.24
	4.00–10.00			16%	81%	3%		33.6%	\$6.67
	10.00–50.00				19%	81%		35.3%	\$19.90
	> 50.00					29%	71%	4.5%	\$94.59
% of Pop.		4.7%	11.1%	14.2%	35.4%	31.3%	3.3%	100%	\$14.15
Mean Income		\$0.86	\$1.90	\$3.25	\$6.61	\$19.40	\$91.54	\$12.17	

Figure 9 – Distribution of Market Income and Distribution of Public Spending on Education and Health (by decile)

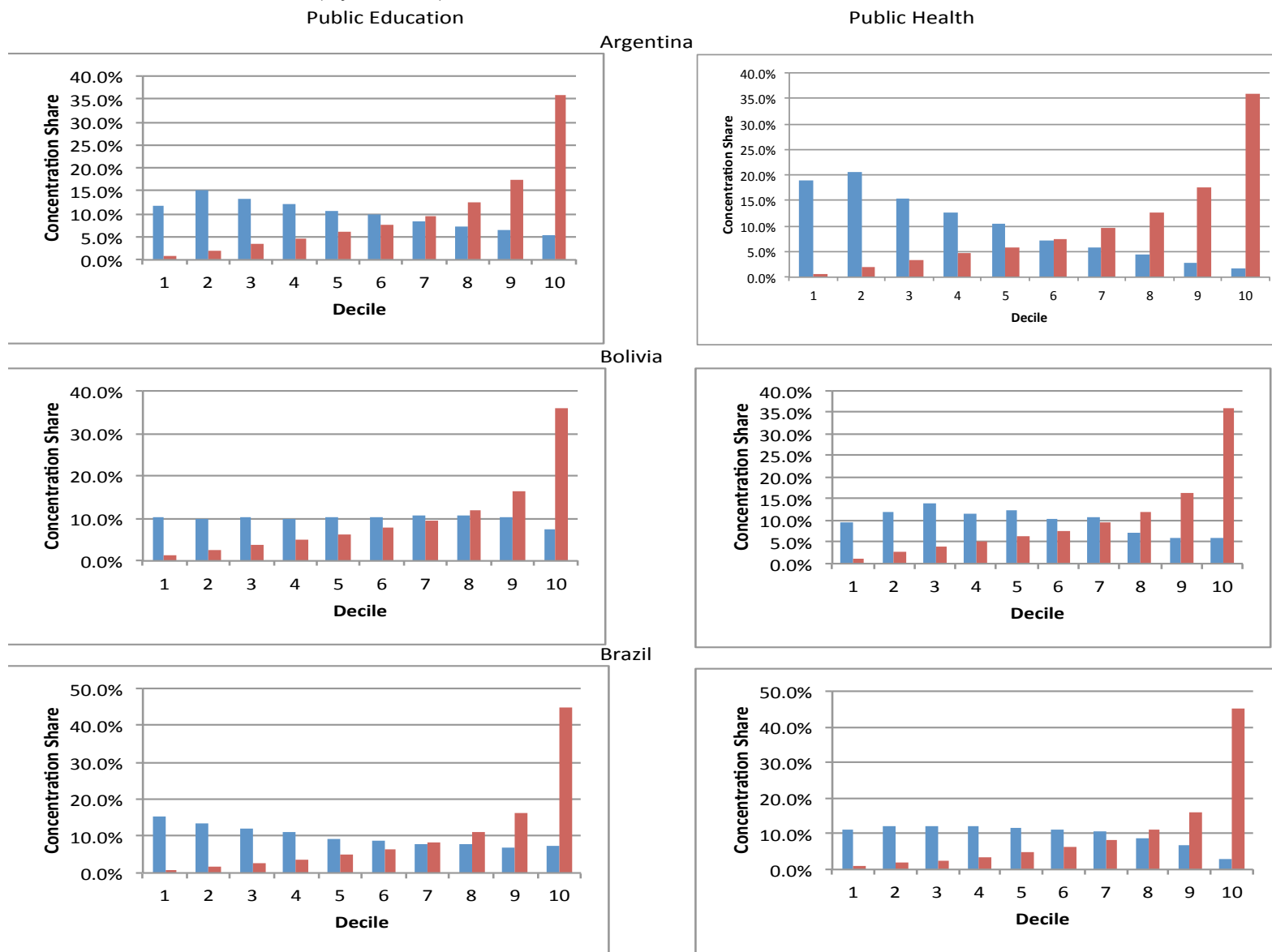
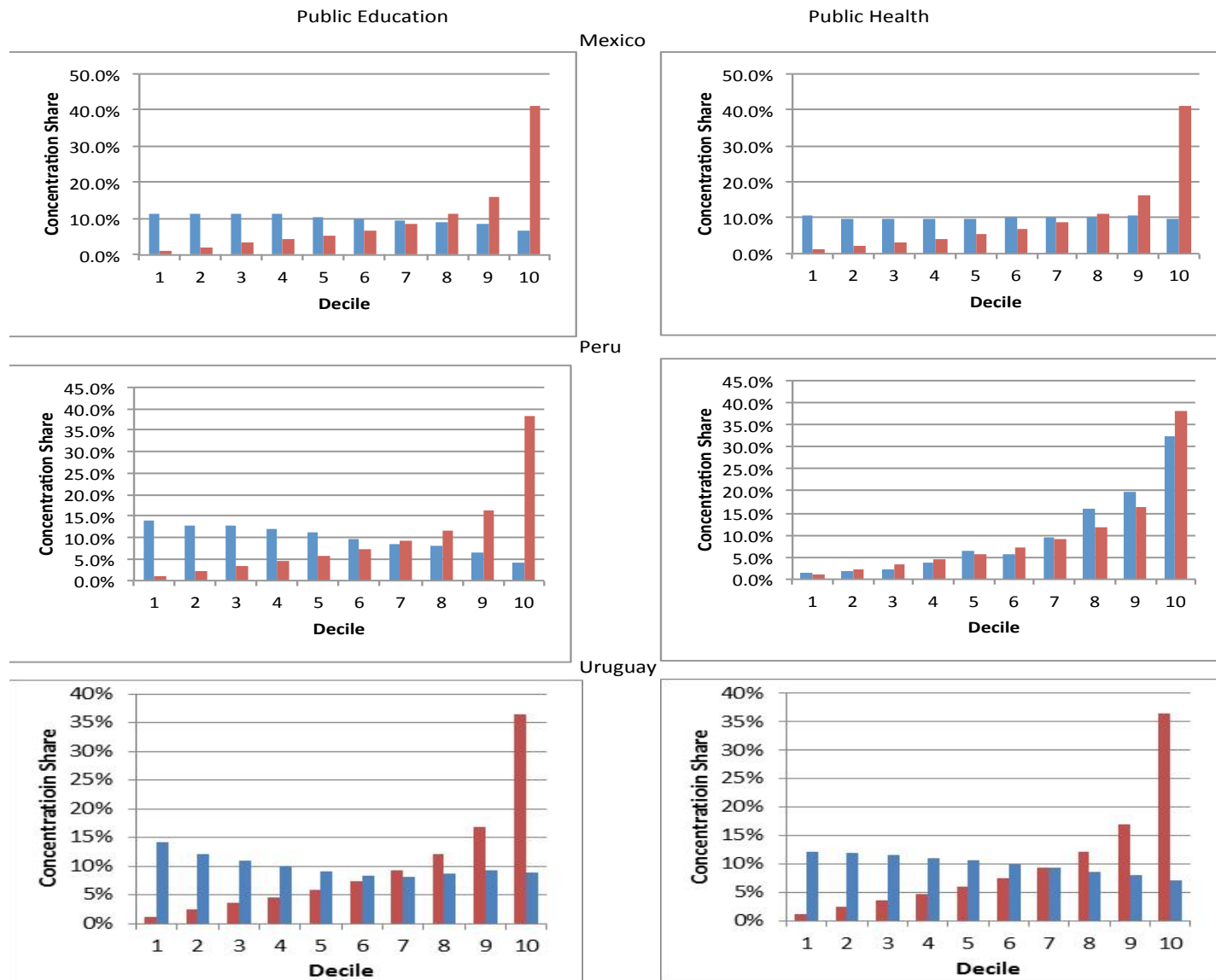


Figure 9 (continued)



Source: Lustig, coordinator (2012).

Challenges

- Global slowdown => commodity boom fizzles, fiscal space vanishes
- Generating sustainable revenues and regressiveness of indirect taxes
- Taxing the rich
- Safety nets for the excluded poor
- Safety ropes for the poor and the vulnerable
- Social protection for rising food prices

Potential Questions

- Costing closing the income poverty and human capital gaps of the poor and the vulnerable
- Costing compensating the poor and vulnerable for downward movement due to indirect taxes
- Costing “Opportunities for All” (WB project)
- Redistribution, higher public spending, economic growth?